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California Independent Bankers

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September 22, 2005

Honorable Donald E. Powell
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Mr. John F. Carter
Regional Director
Federal Deposit Insurance Corporation
25 Jessie Street at Ecker Square, Ste 2300
San Francisco, CA 94105

Re: Comments Regarding FDIC Application #20051977; Wal-Mart Application for Insurance and Industrial Bank Charter

Dear Chairman Powell and Mr. Carter:

I am writing to comment on the Wal-Mart Stores, Inc. application for a Utah industrial loan company charter (ILC) and federal deposit insurance. I oppose the application and urge the FDIC to deny the application. I encourage the FDIC to conduct a public hearing on the application to allow small business owners and bankers to testify as to the destructive impact of Wal-Mart Bank.

Despite the narrow business plan proposed by Wal-Mart, the application to establish an ILC presents serious issues regarding the appropriate structure of our national banking system. A bank owned and operated by the world's largest retailer will expose the industry to a dangerous mixing of banking and commerce, distorted credit decisions, unstable economic concentration, superficial banking supervision, overextension of the federal safety net, potential losses to the taxpayer and long term community disinvestment. For these reasons, the California Independent Bankers urges the FDIC to deny Wal-Mart's application.

Commercial ownership of ILCs is prohibited in California and Colorado

Limiting the ownership of ILCs is not unprecedented. There are 58 ILCs chartered in seven states: California, Colorado, Hawaii, Indiana, Minnesota, Nevada and Utah. Of these, California and Colorado prohibit commercial ownership.

The California prohibition arose in response to Wal-Mart's attempt to purchase a failing California ILC in 2002. Acting in support of the Federal Reserve and citing the federal prohibition on commercial ownership of unitary thrifts as mandated in the 1999 Gramm-Leach-Bliley Act, the California legislature overwhelmingly voted to prohibit the future ownership of a California ILC by any commercial firm. In signing the law, California Governor Gray Davis remarked that the continued separation between banking and commerce is critical to the safety and soundness of our financial system, particularly in light of the recent accounting and balance sheet irregularities in the corporate world, such as Enron, WorldCom and Tyco.

Lack of umbrella supervision promotes unsafe practices & puts the insurance fund at risk

The economic strength and general welfare of California depends on strong and sound financial institutions that are closely supervised federal and state regulatory agencies. The modern ILC has little resemblance to the humble credit cooperatives of long ago. The modern ILC operation has jettisoned its founding purpose and has outgrown the system created to regulate it.

Financial holding companies are subject to Federal Reserve "umbrella" supervision". This level of supervision permits the Federal Reserve to continuously inspect the bank and the parent company. Umbrella supervision assures that the parent has adequate company-wide systems to measure and to manage risks across multiple legal entities. In comparison, FDIC supervision is limited to investigating the ILC with limited supervision of the commercial parent. Thus, there is no regulatory evaluation of company-wide risk management systems and controls.

In a 2003, Chairman of the Federal Reserve, Alan Greenspan, questioned the adequacy of ILC supervision stating, "[t]hese large insured ILCs with unregulated parents could be placed at significant risk by the operations or difficulties of their parent."¹ The 2005 report on ILCs from the General Accounting Office (GAO) reiterated these concerns, saying, "FDIC authority over parent companies is limited to certain circumstances, and such authority has never been tested."²

The parent commercial corporation of an ILC is not subject to the same regulations and restrictions as a financial holding company. **Strict regulation of the ILC commercial parent is essential because the obligations of a commercial corporation to its shareholders may be incompatible with the traditional fiduciary relationship between bank depositors and the financial institution.** This difference highlights the substantial flaw in ILC regulation: there is no regulatory counterbalance to assure the safety of depositors' funds from unauthorized corporate use. Ultimately, this lack of oversight and regulation of the corporate parent threatens to undermine the stability of the federal deposit insurance system.

What would have happened to consumers if Enron had a bank?

Given the recent spate of accounting and balance sheet irregularities in the corporate world, such as Enron, WorldCom and Tyco, maintaining the separation between banking and commerce is critical. If the commercial enterprise fails, the bank may fail with it, as was the case in the Asian financial crisis in the 1990s. Recently, the *American Banker* newspaper echoed this concern, citing the September 2005 GAO study, stating "it is unclear that the FDIC will have the resources available to shore up an ILC if the parent corporation fails."³ The cost of a failed commercially owned bank might include loss of individual savings, harm to the FDIC deposit insurance program and reduced consumer and investor confidence in the American banking system.

¹ Heller, Michelle. ILCs to Get Fed Oversight? GAO report cited; Leach set to introduce bill, *American Banker*, No. 183. September 22, 2005 citing Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority. GAO Report GAO-05-621, a report to the Honorable James S. Leach, House of Representatives.

² *Id.*

³ See *id.*

Expansion of Utah ILCs creates a concentration of financial risk.

Of the 58 operating ILCs, 36 are located in Utah. That means approximately 62% of all ILCs operate in one state. This is unsafe.

If Wal-Mart and other retailers are permitted to establish additional Utah chartered ILCs, Utah will become oversaturated with the presence of too many financial institutions of a single charter type engaged in the same line of business. This will create a high concentration of financial risk in Utah and tempt another financial crisis like the savings and loan problems of the 1980s.

Exploding ILC growth will cause the return of FDIC insurance premiums

From 1987 to 2004, ILC assets have grown 3500%, to \$140 billion. The unprecedented ILC growth will continue as the charter becomes popular among retail corporations and traditional limited purpose ILCs begin to offer of retail banking services to the public at large⁴.

The ILC business model is beginning to transition from traditional limited purpose asset based lending to full retail banking. This model is particularly attractive for retailers who can parlay their relationship with the consumer into a banking relationship with credit cards, FDIC-insured saving & checking accounts, money market account, certificate of deposits, consumer loans, mortgages and equity lines of credit.

Continued asset growth and the pressure it will place on deposit ratios will cause other FDIC-insured banks, which are more strictly regulated, to begin paying FDIC premiums to subsidize the deposits of the less regulated and more risky ILCs.

Access to customers' confidential financial information may led to predatory practices

When large retailers enter the banking business, we must consider whether the public's personal information is adequately protected from misuse.

Retailers have access to private medical information through their in-store pharmacies and corporate owned insurance companies. With the approval of a retailer-owned ILC, they have access to personal financial information held by the retailer-owned bank. There is no limitation on a retailer's ability to use confidential medial and financial information to market products to the consumer or to sell the confidential information to other commercial firms. Thus, it is possible that a business enterprise with an ILC could use the economic power of its depositors coupled with their confidential medical and financial information to engage in unsafe and unethical predatory behavior.

⁴ The current trend for ILCs is to offer retail-banking services online to the public.

Utah chartered **Volkswagen Bank USA** (www.vwbankusa.com) offers savings accounts, interest-bearing personal checking accounts, certificates of deposit, home equity lines of credit and credit cards.

Nevada chartered **Toyota Financial Savings Bank** (www.toyotafinancialdealerbanking.com) offers retail banking services (Money market and savings accounts, certificates of deposit and cash management services) to its dealers. According to the business plan filed with the Nevada Department of Financial Institutions, the long-term strategy was to rollout retail banking services, mortgages and insurance products to the affluent Lexus owners and buyers. In August 2005, Toyota Financial Savings Bank applied to change its name to Lexus Financial Savings Bank.

Utah chartered **BMW Bank of North America** (<https://fs.bmwusa.com/BmwFsPulp>) did offer online retail banking services (checking and savings accounts, certificates of deposit and equity lines of credit). BMW Bank has discontinued opening new accounts for the remainder of 2005.

Nevada chartered **Eaglemark Savings Bank** (www.eaglemark.com), a subsidiary of Harley Davidson Financial Services, has grown beyond financing motorcycles to offer "comprehensive financial services to the aircraft industry" to finance the purchase, maintenance or upgrade of light aircraft.

No social benefit is derived from permitting Wal-Mart to operate an ILC

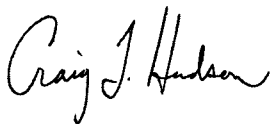
If Wal-Mart or any commercial or retail firm wants to provide retail banking services to its customers, it may without breaching the banking and commerce restrictions by partnering with an established bank to offer banking services in each store.

Currently, there are a large number of community banks that offer banking services in department store branches, including Wal-Mart. Thus, there is no clear policy reason or social benefit from severing local businesses and consumers from local banks by allowing any commercial firm to own and control a banking establishment.

Conclusion

For the reasons listed above, the California Independent Bankers urges the FDIC to reject Wal-Mart's application for federal deposit insurance for a Wal-Mart ILC. Limitations on the ownership of ILCs are not unprecedented. The legislatures of California and Colorado have prohibited commercially-owned ILCs due to their strong concerns about the inherent dangers of mixing banking and commerce. Of particular concern are the effect of corporate failures on the stability of a subsidiary ILC and the resultant harm to federal deposit insurance and public confidence in the American banking system. The continued expansion of Utah ILCs will create a concentration of financial risk in the West and will spur the return of FDIC insurance premiums. There is growing concern that a retail-owned ILC will be unable to protect the confidential information of its account holders from the corporate parent and resulting customer profiling or unethical predatory behavior. Ultimately, there is no clear social benefit derived from permitting Wal-Mart to operate an ILC. Our nation's banking system is based on the principal of keeping banking and commerce separated. There is no reason to undermine the banking industry and the public's confidence in it by giving the largest corporations unfettered access into our stable, well-managed and highly respected payments system.

Cordially,



Craig L. Hudson
Executive Director



Steven K. Buster
President, California Independent Bankers
President & CEO, The Mechanics Bank



Denyette DePierro
Director of Bank Relations
Legislative Representative